UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15518

In the Matter of **DIEGO F. HERNANDEZ, THE WEALTH MANAGEMENT PARTNERS, LLC, WEALTH FINANCIAL, LIMITED LIABILITY COMPANY, DFHR INVESTMENTS, INC., and HD MILE HIGH MARKETING, INC.**	**DIVISION OF ENFORCEMENT'S PREHEARING BRIEF**

I. SUMMARY

This case involves fraudulent conduct by Diego Hernandez, a registered representative, who caused customers to surrender existing annuities or other securities, then sold investments away from his associated firms, and simply stole his customers' funds. From 2005 through April 12, 2012, Hernandez was a registered representative at Allstate Financial Services, LLC ("Allstate"), and then he was registered with AXA Advisors, LLC ("AXA") until January 31, 2013, when he was terminated. Beginning in 2011, Hernandez began his fraudulent conduct selling investments away from his associated firm to existing and new customers. All told, Hernandez raised approximately $921,000 from fifteen customers. Hernandez's sales pitch varied but he generally promised safe investments and stable returns. Ultimately, however, Hernandez misappropriated his customers' funds, spending the money on living expenses,

expenses associated with various entities that he controlled, to repay loans, or repay other customers when they demanded return of their funds.[1]

Based on this fraudulent conduct, the Commission issued an Order Instituting Proceedings charging Hernandez with violations of antifraud provisions of the Securities Act and Exchange Act, and for acting as an unregistered broker dealer by selling away from his associated firms. The Commission also charged the entities that Hernandez used to facilitate his sales and misappropriation of customer funds. The Division seeks a cease and desist order for the violations alleged against Hernandez and his entities, disgorgement plus prejudgment interest, associational bars, and civil penalties. As explained further below, given Hernandez' egregious conduct, the Division is entitled to the relief it seeks.

II. RESPONDENTS

Diego Hernandez ("Hernandez"), age 39, is a Colombian national, who has been a lawful permanent resident of the United States since he was a child. He received his Series 6 license in 1998. Hernandez was associated with the following firms from 1998 to 2012: Waddell & Reed, Inc. ("Waddell & Reed") from September 1998 to August 2005; Allstate Financial Services, LLC ("Allstate") from August 2005 to April 2012; and AXA Advisors, LLC ("AXA") from April 2012 to January 2013.[2]

Wealth Management Partners, LLC ("Wealth Management"), is a Colorado limited liability company with its principal place of business in Lakewood, Colorado. Hernandez

[1] In this Administrative Proceeding, the Division will call the following customers of Hernandez, as witnesses: [redacted]. The Division will also call, [redacted]r, an SEC accountant, S[redacted] an Allstate representative and [redacted], and AXA representative and Hernandez's supervisor while at AXA.

[2] On June 20, 2013, Hernandez entered into a Letter of Acceptance, Waiver and Consent with FINRA whereby, without admitting or denying FINRA's findings, he consented to a bar from association with any FINRA-regulated firm in any capacity based on his violations of various FINRA rules, by refusing to provide documents and information in connection with FINRA's investigation of his termination by AXA, and failing to disclose to AXA certain outside business activities.

formed Wealth Management on March 28, 2012. Hernandez owns and controls Wealth Management and is the signatory on its bank accounts. Wealth Management has never registered with the Commission. Hernandez used Wealth Management to receive customer funds.

Wealth Financial, Limited Liability Company ("Wealth Financial"), is a Colorado limited liability company with its principal place of business in Lakewood, Colorado. Hernandez formed Wealth Financial on February 5, 2013. Hernandez owns and controls Wealth Financial and is the signatory on its bank accounts. Wealth Financial has never registered with the Commission. Hernandez used Wealth Financial to receive customer funds.

DFHR is a Colorado corporation. Hernandez formed DFHR on November 11, 2009, but it has been in delinquent status with the Colorado Secretary of State since May 1, 2011. Hernandez owns and controls DFHR and is the signatory on its bank accounts. DFHR has never registered with the Commission. Hernandez used DFHR to receive customer funds.

HD Mile High Marketing, Inc. ("HD Mile High"), is a Colorado corporation with its principal place of business in Lakewood, Colorado. Hernandez formed HD Mile High on December 7, 2011. Hernandez owns and controls HD Mile High and is the signatory on its bank accounts. HD Mile High has never registered with the Commission. HD Mile High is a marketing agency that focuses on advertising boards placed in elevators, lobbies, and restrooms. Hernandez used HD Mile High to receive customer funds.

III. FACTS

A. Background.

Hernandez started his career as a registered representative with Waddell & Reed in 1998, and obtained a Series 6 license. In 2005, he moved to AllState, and in April 2012, he

moved to AXA until he was terminated in January 2013. During his nearly fifteen years as a registered representative, Hernandez generally put his customers' funds into mutual funds, annuities, and life insurance. Over this time frame, he became acquainted with many of the customers that are relevant to this matter. Through his dealings with them, Hernandez became their trusted "financial adviser." Many of these customers followed Hernandez from firm to firm, sometimes unwittingly.

During the period at issue, Hernandez set up several entities that he owned and controlled, such as DFHR, HD Mile High, and Wealth Management. Hernandez used DFHR purportedly to receive commissions and to pay expenses associated with his brokerage business. Hernandez used HD Mile High, Wealth Management and DFHR purportedly to conduct business apart from his brokerage business. Because Hernandez was associated with a variety of firms and entities, his customers generally did not question his instructions that they direct payments to a Hernandez entity in order to invest through him.

B. Hernandez begins his scheme while at Allstate using his company DFHR.

When Hernandez moved to Allstate in 2005, most investors accepted his move without asking any questions and continued to rely on Hernandez as their "financial adviser." Hernandez incorporated DFHR in November 2009, but he failed to disclose to Allstate his outside business activities at DFHR. In 2011, Hernandez used DFHR to start his fraudulent offering. Hernandez convinced four investors to provide investment funds to DFHR, and he deposited their funds in DFHR's bank account. He spent their money on business and personal expenses.[3] Those four investors were Karin Martinez, Marion Burch, Robert Gutierrez and Mr. and Mrs. Guzek.

[3] Hernandez lied on his Allstate annual compliance questionnaire and his outside business activities report. On his annual compliance questionnaire Hernandez answered "no" to two questions: 1) In the past 12 months, have you engaged in soliciting, referring, or recommending any private placements or private securities products? and 2) In the past 12 months while associated with AFS, LLC have you solicited or accepted a loan from or made a loan to a

Prior to 2011, Hernandez had investor [redacted] as a brokerage customer. She invested with Hernandez again in July 2011, writing a check to DFHR. Hernandez told her he was putting her funds into a one year CD. [redacted] wrote on the check memo: "one yr. cd." Hernandez did not provide her with any offering documents or account statements. Instead, Hernandez just deposited her funds into DFHR's bank account and spent the money.

Hernandez also convinced [redacted] to invest $22,944.44 by writing a check to DFHR. She thought her money was going into an investment fund that Hernandez told her was safe, low risk and was a place her money could grow. Hernandez did not provide her with any offering documents.[4] Hernandez deposited her funds into DFHR's bank account and spent the money.

Another investor, [redacted], invested $84,049.32[5] by writing checks to DFHR. Hernandez told Gutierrez that these amounts were being invested in safe, low risk, retirement funds. Instead, Hernandez put the funds into DFHR's bank account. Hernandez wrote checks for payroll and other matters unrelated to the purported investments.

In January 2012, Hernandez asked the Guzeks to invest through him. In 2012, they wrote checks to DFHR. In total, the Guzeks invested over $94,000. Hernandez told the Guzeks that the monies were going into a low risk "fund" that was safe and would grow at a better rate than

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customer for any reason?" Hernandez admitted in investigatory testimony that he should have answered "yes" to these questions. On his outside business activities report for Allstate, Hernandez also answered "no" to the question: "Does this business involve the sale of products or services not offered through the firm." He testified that he should have answered yes. He also told Allstate that he spent 10% of his time on Mile Hi Marketing, his marketing business, but admitted in his investigatory testimony that he actually spent almost 100% of his time on this business. He also admitted that he raised funds from investors for HD Mile High but he answered "No" to the question "Do any of your duties include investment-related activity, including raising capital or issuing debt?"

[4] [redacted] and her husband are both deceased. During his investigative testimony, Hernandez provided information about the circumstances of her investment.

[5] [redacted] invested $25,000 in August 2011, $20,000 in September 2011, $34,000 in October 2011 and $3800 in November 2011. In 2012, [redacted] invested $93,000 in Wealth Management.

their current investment. Instead, the money went into DFHR's bank account. Hernandez wrote checks for payroll, rent and other expenses unrelated to the purported investment.[6]

C. Hernandez convinced three investors to make payments to HD Mile High.

Hernandez solicited funds for HD Mile High in the same manner he solicited funds for DFHR. Hernandez incorporated HD Mile High on December 7, 2011. [redacted] became Hernandez's customer while he was at Allstate. In March 2012, he solicited [redacted] to write a check to HD Mile High. Hernandez told her that her that this investment was going into a low risk, safe fund and would grow. [7] He also told her that the investment was liquid and he could return some of her money at any time. This was important to [redacted] because she needed some of the money to pay for school. He refused to give her any documents relating to the investment saying he would "send it later." But, Hernandez simply put the money in his bank account and spent the money on personal and business expenses.

D. Hernandez incorporates Wealth Management in March 2012.

Hernandez moved from Allstate to AXA in April 2012. The month before he incorporated Wealth Management. Hernandez began soliciting customers to invest in the Wealth Management "fund," representing that it was a safe, low-risk fund that would grow at a greater rate than their current investment. Specifically, he told customers that Wealth Management was a "fund," that had a "market value," and the investment in the fund was very safe, just like the mutual funds or annuities they moved out of, only they would make more money. Between April 2012 and January 2013, Hernandez solicited ten customers to provide funds to Wealth

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[6] [redacted], [redacted]z and [redacted] also wrote checks to Wealth Management in 2012.

[7] Hernandez also solicited Daniel and Linda Volini to invest $70,000 and Matthew Hawley to invest $1000 in HD Mile High. Hernandez admitted in investigatory testimony that he repaid Volini and Hawley, who were both his friends, using other investor funds.

Management, again selling away from his current firm, AXA.[8] Some of these customers had previously been solicited to invest in DFHR, when Hernandez was selling away from Allstate.[9]

For example, [redacted] knew Hernandez because her parents, [redacted], had been his customers.[10] She viewed Hernandez as her family's trusted advisor. Hernandez went to her home several times to discuss her investments. He told her he could make better money for her in another fund. In the second half of 2012, [redacted]'s father passed away and she inherited his $25,440.00 IRA. Hernandez advised [redacted] to put this IRA into a corporate bond called the "Wealth Management fund." He also convinced [redacted] to surrender her annuity account with Prudential, transfer the money to her checking account and then write a check to Wealth Management. He represented to her that her investment in the corporate bond was safe, low risk and that her money would grow faster than her current investment. He offered her a six percent bonus for investing in the Wealth Management fund. He never told her about the surrender fee for liquidating her annuity and never told her about penalties for moving money from an IRA to his entities, which was a non-IRA account

The following chart shows a summary of the customers who invested through Hernandez. The chart shows the total funds invested, the funds invested by customer, and the amount of funds invested into each Hernandez entity, as follows:

[8] The ten customers are [redacted]

[9] [redacted]

[10] It turns out Hernandez took $22,944.44 from her mother, [redacted]. *See* Section III. B, *supra.*

Investors	
[redacted]	$ 317,000
[redacted]	$ 176,000
[redacted]	$ 70,000
[redacted]k	$ 61,000
[redacted]	$ 50,000
[redacted]	$ 50,000
[redacted]	$ 40,000
[redacted]	$ 30,000
[redacted]	$ 30,000
[redacted]	$ 27,000
[redacted]	$ 27,000
[redacted]	$ 23,000
Others*	$ 20,000
Total	**$ 921,000**

[redacted]	
Wealth Management Partners LLC	$ 256,000
Wealth Financial LLC	$ 61,000

[redacted]	
Wealth Management Partners LLC	$ 12,000
	$ 81,000
DFHR Investments, Inc.	$ 4,000
	$ 20,000
	$ 25,000
	$ 34,000

[redacted]	
HD Mile High Marketing	$ 70,000

[redacted]	
Wealth Management Partners LLC	$ 15,000
DFHR Investments, Inc.	$ 10,000
	$ 10,000
	$ 26,000

[redacted]	
HD Mile High Marketing	$ 50,000

[redacted]	
Wealth Management Partners LLC	$ 10,000
	$ 20,000
DFHR Investments, Inc.	$ 20,000

[redacted]	
Wealth Management Partners LLC	$ 40,000

[redacted]	
Wealth Management Partners LLC	$ 30,000

[redacted]	
Wealth Management Partners LLC	$ 30,000

[redacted]	
Wealth Management Partners LLC	$ 27,000

[redacted]	
Wealth Management Partners LLC	$ 12,000
	$ 15,000

[redacted]	
DFHR Investments, Inc.	$ 23,000

[redacted]	
Wealth Management Partners LLC	$ 7,000
	$ 7,000

[redacted]	
Wealth Management Partners LLC	$ 5,000

[redacted]	
HD Mile High Marketing	$ 1,000

E. Hernandez misappropriated his customers' funds.

As indicated above, four customers put their funds in DFHR. Hernandez deposited their funds into the DFHR checking account and Hernandez wrote checks for payroll, made a loan to a friend and took out cash.

Three investors wrote checks to HD Mile High. At the time, the HD Mile High bank account showed a balance of $16.63. After Hernandez put the customers' money in the bank account, he spent it on, among other things: $10,000 to settle a personal debt with Public Service; $3,500 to settle a personal debt with Capital One Bank, $6,000 in payments to the co-owner of Peak Training Center, another company Hernandez owned.

In January and February 2013, Hernandez had customers write $338,759 in checks to Wealth Management, representing to them that Wealth Management was a fund that was safe,

low-risk and secure fund. Before any of these investments, the Wealth Management bank account was overdrawn by ($97.21). Hernandez quickly depleted these invested funds by spending them on: $10,000 for payments to employees; payments for his own residential rent and the residential rent for one employee; $800 for a trip to Vail, Colorado; $15,000 for a vehicle; and $90,000 to HD Mile High.

F. A customer reports the conduct to AXA, who terminates Hernandez.

A CPA for [redacted] contacted Hernandez in December 2012, and demanded that he return [redacted]'s money. The CPA advised Hernandez, in an email, that she had discussed [redacted]'s case with other advisors and legal professionals, and stated: "What you are doing to Mr. [redacted] (sic) is not only unprofessional but bordering on illegal." She stated she had contacted the Attorney General of the State of Colorado and filled out a securities fraud complaint and was ready to submit it unless they returned [redacted]'s money. She also reported the conduct to AXA, who conducted an investigation and terminated Hernandez on January 31, 2013.[11] The AXA termination letter stated:

> This is to advise you that AXA Network, LLC and AXA Advisors LLC hereby elect to terminate your Agent's Agreement and your Registered Representative's Agreement immediately due to your failure to comply with all of the provisions and conditions of your agreements, AXA policies and FINRA rules in connection with your undisclosed outside business activity and the commingling and conversion of funds.

On the same day that Hernandez was terminated by AXA, he went to a customer's house, [redacted], and convinced her to write a check to Wealth Management for $27,216.79. [redacted] was another long-time customer of Hernandez. He told her that her funds would be invested in a safe, low-risk investment and she would make more money than she was making in her previous

[11] Hernandez testified about this email and discussions with the CPA in his investigatory testimony and blames the CPA for his termination. Hernandez did returned $102,000 to [redacted]z, using other investors' monies. He also returned funds to his friends. Ultimately, Hernandez returned $211,000, using other investors' monies.

investment with Prudential. At the time of her investment, [redacted] was unemployed and living in an assisted living facility. Hernandez convinced her to invest her entire retirement account.

G. Hernandez misappropriates [redacted]'s check after the Division's investigation begins.

On January 24, 2013, [redacted] gave Hernandez a check for $60,014.00, which represented funds previously held in her Lockheed Martin Salaried Saving Plan (401k). Hernandez advised her to cash out of the account and write a check to Wealth Financial. Hernandez did not cash the check immediately. In March 2013, the Division subpoenaed Hernandez and the banks where the entities had accounts. The Division also contacted customers, including [redacted]. [redacted] called the bank to have the bank stop payment on her check, but found out that Hernandez had just opened a new bank account for Wealth Financial in April 2013, where he deposited [redacted]e's check.[12] With [redacted]'s money Hernandez paid several employees of Wealth Financial and paid HD Mile High, his marketing company.

H. Hernandez altered documents before providing them to the Division.

As indicated, the Division issued a subpoena to Hernandez during its investigation. In response, Hernandez provided altered documents to the Division. He altered the customer account statements that used the terms "corporate bonds," "investments," "fund," and "market value," to describe the investments that he had offered to his customers. He changed the account statements to read as if the customer had loaned him money, listing the investment as "promissory note." He also drafted bogus promissory notes for the customers. He admitted in his testimony that he got the promissory note form from a Google legal form file. To further the fraud, he sent some customers account statements describing the investments as a "promissory

[12] Although Hernandez used "Wealth Financial" on the account statements, he had not registered the entity with the Secretary of State until February 2013, after his termination from AXA. In April 2013, he opened a new bank account for Wealth Financial and deposited [redacted] check. All of the other accounts of Hernandez and his entities had been served with a subpoena by the Division.

note" more than a year after they made their investment. Hernandez admitted in testimony that these "promissory note" account statements were made after he got terminated from AXA. No customer ever agreed to enter into a "promissory note" with Hernandez or his entities, and he never gave any of these customers the "promissory note" account statements before the SEC investigation began.

IV. LEGAL ARGUMENT

A. Respondents sold securities.

In analyzing whether instruments are securities, the overarching presumption, rooted in statutory law, is that a "security" includes "virtually any instrument that might be sold as an investment," "in whatever form they are made and by whatever name they are called." *SEC v. Edwards,* 540 U.S. 389, 391 (2004), *citing, Reves v. Ernst & Young,* 494 U.S. 56, 61 n. 1 (1990). "Congress' intent [was] to regulate the entire body of instruments sold as investments." *Id.* at 64. Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act[13] define a "security" for purposes of the federal securities laws to include notes, stock, certificates of participation in profit-sharing agreements, and investment contracts.

Hernandez sold corporate bonds and/or promissory notes to his customers. Corporate bonds and promissory notes are essentially the same type of instrument: both are notes. A note's presumed status as a security is confirmed when 1) the parties are motivated by an investment purpose, 2) the note is sold to a broad segment of the public, 3) a reasonable investor would consider the note to be an investment, and 4) alternative regulatory schemes do not significantly reduce the risk of the instrument. *See Reves v. Ernst & Young*, 494 U.S. at 66-69.

Under the circumstances of this case, the notes are securities. First, the parties were motivated to make an investment. The customers gave Respondents the money to invest so the

[13] 15 U.S.C. §77(b)(a)(1); 15 U.S.C. §78(c)(a)(10).

fund they purportedly had invested in would pay interest and grow. Many customers thought they were just transferring money previously held in The Ivy Funds, an annuity, or in a 401(k) plan. Hernandez simply convinced them that they should move their investment elsewhere. Second, although Hernandez did not necessarily sell his notes to a broad segment of the public, this fact is not dispositive. The Court must weigh this factor against the purchasing individual's need for the protection of the securities laws. *McNabb v. SEC,* 298 F. 3d 1126, 1132 (9th Cir. 2002). In this case, the investors were all individuals, unsophisticated investors, and some of them were elderly. Here, the protection provided by the securities laws would benefit the individual investors in this case. *Id.; SEC v. Global Telecom Servs. L.L.C.,* 325 F. Supp. 2d 94 *115 (D. CT 2004) (Where the notes are sold to individuals rather than "sophisticated institutions," common trading has been found, *citing Stoiber v. SEC,* 161 F. 3d 745, 752 (D.C. Cir. 1998)). In addition, an offering to a limited number of investors can meet the *Reves* test. For example, in *Deal v. Asset Mgmt. Group,* 1992 WL 212482 at *4 (N.D. Ill. 1992), the court concluded that a plan of distribution involving "an offering to six investors who did not appear to be linked in any way except as customers of [Defendant] was enough to constitute a "broad segment of the public." Regarding the third *Reves* factor, the objective expectations of the customers were such that they believed that they had made an investment. Hernandez told his customers that he was investing their money, he often represented that the investment was in corporate bonds, he provided at least two customers hypothetical reports regarding an "Independent Fixed Rate Securities" and he provided several customers with account statements that described the transactions as "investments" in "corporate bonds." Regarding the fourth factor, there were no risk-reducing factors or regulatory schemes in place to protect investors.

The money was just placed into Hernandez's companies. For these reasons, balancing the *Reves* factors, the notes should be presumed to be securities.

The investments offered by Hernandez were also investment contracts under the requirements established in *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298-99 (1946). The definition of "investment contract" is a "flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id.* at 299; *United Hous. Found., Inc.* 421 U.S. 837, 852 (1975). The Supreme Court has defined an investment contract as: (1) the investment of money; (2) in a common enterprise;[14] (3) with an expectation of profits to be derived solely from the efforts of the promoter or a third party. *SEC v. W.J. Howey Co.*, 328 U.S. at 298-99.

Here, the customers made an investment of money in a common enterprise with the expectation of receiving interest and return of the principal at the end of the term, satisfying both the first and second elements of *Howey*. The customers expected to earn profits in the form of interest. They received statements from Hernandez showing interest on their investment. The *Howey* test is met here because: (1) customers placed their funds with Hernandez or his entities, with the intent to invest and make a financial return on their investment; (2) Hernandez, through his entities, pooled customer funds into a bank account that Hernandez controlled, and customers' losses were shared; and (3) the customer were passive, meaning that any profits would be generated by the efforts of Hernandez and his entities. *SEC v. Edwards,* 540 U.S. at 394.

[14] The Commission has held that, "common enterprise" is not a distinct requirement for an investment contract under *Howey.* The term "investment contract" came from state blue sky laws and means "a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment.'" *SEC v. Edwards,* 540 U.S. 389, 394 (2004); *In re Natural Resources Corp.,* 8 S.E.C. 635 (1941).

B. Respondents violated the Antifraud Provisions of the Securities Act and the Exchange Act.

Hernandez and each of his entities violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 enacted thereunder.[15] These antifraud provisions "prohibit the employing of fraudulent schemes or the making of material misrepresentations and omissions in offers, purchases, or sales of securities." *SEC v. Dain Rauscher, Inc.*, 254 F. 3d 852, 855-56 (9th Cir. 2001) (noting that the antifraud provisions, "prohibit fraudulent conduct or practices" and "forbid making a material misstatement or omission" in connection with the offer or sale of securities.)

The antifraud provisions are "to be construed 'not technically and restrictively' but flexibly to effectuate their remedial purposes." *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 151 (1972); *Superintendent of Ins. of New York v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971); *SEC v. First Jersey Secs., Inc.* 101 F. 3d 1450, 1466 (2d Cir. 1996). Fundamentally, both Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act are designed to protect "investors from fraudulent practice." *SEC v. Wolfson,* 539 F. 3d 1249, 1257 (10th Cir. 2008); *SEC v. Smart,* 678 F. 3d 850, 856 (10th Cir. 2012).

1. Respondents Hernandez, Wealth Management, and Wealth Financial violated Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder.

Hernandez, Wealth Management and Wealth Financial each violated Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder. To prove a misstatement or omission under Exchange Act Section 10(b) and Rule 10b-5(b), the SEC must demonstrate that a defendant directly or indirectly: (1) made an untrue statement of material fact or omitted to state a material fact; (2) with scienter; (3) in connection with the purchase or sale of a security; and (4) using any means of interstate commerce or of the mails. *SEC v. Wolfson*, 539 F.3d at 1256.

[15] 15 U.S.C. §77q(a), 15 U.S.C. §78j(b), 17 C.F.R. §240.10b-5.

Under Rule 10b-5(b), "the maker of the statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S.Ct. 2296, 2302 (2011). A defendant is liable for his or her own oral misstatements and omissions. *See In re Textron, Inc.*, 2011 WL 4079085, at *6 (D.R.I. Sept. 13, 2011) (defendant CEO of company was maker under *Janus* of oral statements he made during investor conference calls); *SEC v. Dafoitis*, 2011 WL 3295139, at *3 (N.D. Cal. Aug. 1, 2011) (defendant concedes he was maker under *Janus* of oral statement he made during conference call). Information is considered material when there is a substantial likelihood that a reasonable investor would consider it important in determining whether to buy or sell securities. *Basic v. Levinson*, 485 U.S. 224, 231-32 (1988). For omissions, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus. v. Northway*, 426 U.S. 438, 449 (1976).

a. Hernandez made material misrepresentations and omitted material facts.

Hernandez made numerous misrepresentations and omissions. Hernandez met personally with his customers and told them that they should move funds from their current investment into a "fund" recommended by him. He told them that the funds he was offering were safe. He also told [redacted] that her investments had liquidity and that he could return parts of her money at any time. He never provided any customers with offering documents. He also omitted a number of critical facts including: 1) information about surrender fees or penalties paid when selling existing investments; 2) the fact that he and his entities would use their funds to pay business and personal expenses; 3) that he exercised control over the funds; 4) that his

businesses did not generate enough income to pay the promised interest, principal or the bonus that he offered [redacted].

Respondents' misrepresentations were clearly material. Hernandez lied to his customers about where their money was being invested. No customer knew that the money was going into Hernandez's entities. *SEC v. Smart,* 678 F. 3d 850, 856 (10th Cir. 2012) ([I]t would be material to a reasonable investor that his or her money was not being used as represented in safe investment strategies, but rather...for the payment of personal expenses.). Misrepresentations and omissions about the nature of the investment, the use of the investor funds, safety, and control of the funds are material. *SEC v. Research Automation Corp.,* 585 F. 2d 31, 35-36 (2d Cir. 1978) (misleading statements and omissions about the use of investor funds were material as a matter of law); *SEC v. Smith,* 2005 WL 2373849 at *5 (S.D. Ohio, Sept. 27, 2005) ("Certainly a reasonable investor would consider how the Defendants would actually spend his money were he to invest to be an important factor when determining whether to invest in the offering"); *SEC v. Montana*, 464 F. Supp. 2d 772, 783-84 (S.D. Ind. 2006) (investors testimony that "representations and assurances...in particular with regard to the use, safety, rate of return and control of the funds they were investing were important in terms of the investors' decisions to invest).

As a result of Hernandez's conduct, Wealth Management and Wealth Financial are also primary violators of Section 10(b) and Rule 10b-5(b) thereunder. Hernandez provided account statements in the names of these entities to his customers and the statements were false in that they used terms such as "fund" and "market value" to imply that the investments were safe and stable, when in fact, Hernandez simply stole the customers funds. Because Hernandez was the

drafter of these account statements, he is also the "maker" of these false and misleading statements

b. Hernandez acted with scienter.

Scienter is the mental state embracing intent to deceive, manipulate, or defraud. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193 n. 12 (1976). Scienter includes recklessness, defined as conduct that is "an extreme departure from the standards of ordinary care…to the extent that the danger was either known to the "respondent" or so obvious that the [respondent] must have been aware of it. *Gregory O. Trautman,* Exchange Act. Rel. No. 61167 (Dec. 15, 2009), 98 SEC Docket 26534, 26563.

Hernandez acted with scienter. Hernandez: 1) lied to investors about the need to sell existing securities, and never told them about surrender fees or penalties; 2) lied to customers about the investment he was selling them; 3) lied to customers about where their money would go, they were never told that their investment funds would be put into bank accounts of the various entities and would be used to pay personal and business expenses, *SEC v. George*, 426 F. 3d 786, 788-89 (6th Cir. 2005) (concluding that defendants committed securities fraud by telling potential investors that their funds would be invested in certain types of securities, but then commingling the funds and using them 'to pay purported profits to other investors or to make extravagant personal purchases.'); 4) Hernandez never gave customers any information about the entities and did not give them any documents relating to their investment until months, or years later, and those statements were wrong; 5) customers were never told that their funds were being used to pay other investors back; 6) Hernandez lied on the forms he filed with Allstate; 7) Hernandez lied about his termination from AXA to [redacted] never telling her that he had been terminated when he went to her house and took $27,000 dollars from her; 9)

Hernandez misappropriated [redacted]'s check after the Division had started its investigation; 10) Hernandez altered documents before producing them to the Division.

c. Hernandez used the instruments of interstate commerce.

Hernandez used interstate commerce in the sale of securities. Uses of the mail, the telephone, or the internet, all suffice to meet this jurisdictional requirement. *Richter v. Achs,* 962 F. Supp. 31, 33 (S.D.N.Y. 1997)(intrastate telephone calls are sufficient to confer jurisdiction...if a single telephone is used to call the defendants to a meeting at which they engage in fraudulent activity, the jurisdictional element is satisfied.); *SEC v. Save the World Air Inc.,* 2005 WL 3077514 at *9 (S.D.N.Y. Nov. 15, 2005) (addressing the jurisdictional requirements of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, stating: 'the fraud itself need not be transmitted through the jurisdictional means. This extremely broad jurisdictional requirement consequently may be satisfied through a showing that the designated means were used in some phase of the transaction.') Here, investors will testify that they talked with Hernandez on the telephone, they received account statements through the U.S. mail and customers sent Hernandez emails. Hernandez also sent his "falling out" letter relating to his termination from AXA through the U.S. mail to his customers. These uses of the mails or interstate commerce are sufficient to meet the jurisdictional requirements of the securities laws. *SEC v. Save the World Air, Inc.,* 2005 WL 3077514 at *9.[16]

[16] In addition, the fraud was in connection with the purchase and sale of securities. The "in connection with" requirement of Section 10(b) of the Exchange Act is a broad and flexible standard and any activity "touching [the] sale of securities" will suffice. *SEC v. Levine,* 671 F. Supp. 2d 14, 31 (D.D.C. 2009), *citing Superintendent of Ins. v. Bankers Life & Cas. Co.,* 404 U.S. 6, 12-13 (1971). The Supreme Court has consistently embraced an expansive reading of Section 10(b)'s 'in connection with' requirement. *SEC v. Zandford,* 535 U.S. 813, 819 (2002); *SEC v. Gorsek,* 222 F. Supp. 2d 1099, 1111 (C.D. Ill. 2001) ([T]he meaning of [in connection with] in SEC actions remains as broad and flexible as it necessary to accomplish the statue's purpose of protecting investors...essentially the Defendants' actions must merely 'touch' the sale of securities or in some way influence an investment decision"). Here, Respondents convinced investors to sell existing annuities, securities, or to cash out of their 401(k) investments and then write a check to Respondents, who then misappropriated the money.

d. The entities are liable for the same conduct.

The entities are also liable for the same conduct as a result of Hernandez's conduct, because his scienter is imputed to them. *Adams v. Kinder-Morgan, Inc,* 340 F. 3d 1083, 1106-07 (10th Cir. 2003). In this case, the scienter requirement is met.

2. All Respondents are liable for scheme liability under Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) thereunder, and Sections 17(a)(1) and (3) of the Securities Act.

Respondents also violated the scheme liability provisions of the securities laws. Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c)[17] thereunder, make it unlawful, in connection with the purchase or sale of securities to, "employ any device, scheme, or artifice to defraud" or "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person," with scienter. Sections 17(a)(1) and (3)[18] of the Securities Act prohibit the same conduct in the offer or sale of securities. Courts have interpreted these provisions to create what is known as "scheme liability."[19] Rules 10b-5(a) and (c) are "aimed at broader fraudulent schemes" and make it unlawful to, either directly or indirectly, engage in a course of business or employ a device in furtherance of a scheme to defraud in connection with the sale or exchange of securities. *SEC v. Zanford,* 535 U.S. 813, 819 (2002). Similarly, Section 17(a)(1) and (3) of the Securities Act, make it unlawful in the offer or sale of securities to

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[17] 15 U.S.C. § 78j(b), 17 C.F.R. § 240.10b-5(a) and (c).

[18] 15 U.S.C. § 77q(a)(1) and (3).

[19] *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008); *SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 111-12 (2d Cir. 1998); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1471-72 (2d Cir. 1996); *see also SEC v. Lee*, 720 F. Supp. 2d 305, 334 (S.D.N.Y. 2010); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336-37 (S.D.N.Y. 2004); *In re AOL Time Warner, Inc. Sec. and ERISA Litig.*, 381 F. Supp. 2d 192, 217, 229 (S.D.N.Y. 2004).

employ a device, scheme or artifice to defraud or to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

In order to prove scheme liability, the SEC must prove that Respondents directly or indirectly: (1) committed a deceptive or manipulative act; (2) in furtherance of the alleged scheme to defraud; (3) with scienter.[20] *SEC v. Lucent Tech., Inc.*, 610 F. Supp. 2d 342, 360 (D.N.J. 2009); *see also, e.g., In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336 (S.D.N.Y. 2004); *Royal Dutch/Shell Transp. Sec. Litig.*, No. 04-374, 2006 WL 2355402, at *7 (D.N.J. Aug. 14, 2006); *SEC v. Simpson Capital Mmgt.*, 586 F. Supp. 2d 196, 201 (S.D.N.Y. 2008).

The same evidence referenced above support Respondents' scheme liability. For example, Respondents misrepresented the nature of the investments, held the investment out as a fund; misrepresented that there was a "market" for the fund and indicated that the fund was liquid. Hernandez told customers that the funds were safe. He advised customers to provide their cash savings or funds from a 401(k) plan, indicating the funds would be reinvested in a similar retirement plan. Hernandez never told his customers about surrender fees or penalties that they might incur when they sold their annuities; customers were never given any offering documents nor were they told where their money was going; they were never told that their investment would go into checking accounts, controlled by Hernandez, and would be used to pay personal and business expenses. Hernandez and Wealth Financial deposited one investors check well after the investigation was started by the Division and altered documents before producing them to the Division.

[20] However, in order to prove liability under Securities Act Section 17(a)(3), the SEC only has to prove negligence rather than scienter. *SEC v. Smart*, 678 F.3d 850, 857 (10th Cir. 2012).

As discussed in Section IV.B.1.b, Hernandez acted with scienter. Hernandez lied to his customers about the need to sell existing securities, he never told them about surrender fees or penalties they might incur. Hernandez's statements about their investment and the account statements from Wealth Management and Wealth Financial all misrepresented the nature of the investment. Hernandez preyed on his customers, who were unsophisticated investors and were never told that their investment funds would be put into the entities bank accounts and would be used to pay personal and business expenses. The entities are liable for the same conduct as a result of Hernandez's conduct, because his scienter is imputed to them. *Adams v. Kinder-Morgan, Inc.*, 340 F. 3d at 1106-07. Respondents are liable for violating Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c) thereunder, and Section 17(a)(1) and (3) of the Securities Act.

3. All Respondents violated Section 17(a)(2) of the Securities Act.

Under Section 17(a)(2) of the Securities Act,[21] the SEC must prove that Respondents directly or indirectly: (1) obtained money or property by means of an untrue statement of material fact or an omission to state a material fact; (2) with negligence; (3) in the offer or sale of securities; and (4) using any means of interstate commerce or of the mails.[22] A violation of Section 17(a)(2) can be established by a showing of negligence. *Aaron v. SEC,* 446 U.S. 680, 701-02 (1980); *SEC v. Hughes Capital Corporation,* 124 F. 3d 449, 453 (3d Cir. 1997)

[21] 15 U.S.C. §77q(a)(2).

[22] Although Chief Administrative Law Judge Brenda Murray and one district court have applied the standard articulated in *Janus* to claims under Section 17(a)(2) of the Securities Act, *In the Matter of John P. Flannery and James D. Hopkins*, Initial Decision Rel. No. 438 (Oct. 28, 2011); *SEC v. Kelly*, 2011 WL 4431161 at *5 (S.D.N.Y. Sept. 22, 2011), the better rule, supported by several district courts, is to refuse to apply *Janus* to Section 17(a)(2) because "*Janus* was very specifically a decision about claimed violations of Rule 10b-5" and the word "make" does not appear anywhere in Section 17(a). *See SEC v. Stoker*, 865 F. Supp. 2d 457, 465 , 2012 WL 2017736, at *8 (S.D.N.Y. June 6, 2012); *SEC v. Sentinel Management Group, Inc.*, No. 07 C 4684, 2012 WL 1079961, at *14-15 (N.D. Ill. Mar. 30, 2012); *SEC v. Pentagon Capital Mgmt. PLC*, 844 F. Supp. 2d 377, 422, 2012 WL 479576, at *42 (S.D.N.Y. Feb. 14, 2012); *SEC v. Mercury Interactive, LLC*, No. 5:07–cv–02822, 2011 WL 5871020, at *3 (N.D. Cal. Nov. 22, 2011); *SEC v. Geswein*, No. 5:10CV1235, 2011 WL 4565861, at *2 (N.D. Ohio Sept. 29, 2011); *Sec v. Daifotis*, 2011 WL 3295139 at *5-6 (N.D. Cal. Aug 1, 2011).

(summary judgment granted because defendant had enough information about the conduct to show that she was at least negligent).

The same evidence referenced above supports violations under these provisions. In short, Respondents obtained investor funds using material misrepresentations and omissions in the offer or sale of securities and then placed them into the Respondents' bank accounts, controlled by Hernandez. They then misappropriated the money and spent it on personal and business expenses.

C. Respondents Hernandez, Wealth Management, Wealth Financial, and DFHR Violated Section 15(a) of the Exchange Act.

Hernandez, and Hernandez's entities Wealth Management, Wealth Financial, and DFHR each violated Section 15(a) of the Exchange Act.[23] Section 15(a) of the Exchange Act makes it illegal for a broker to attempt to induce the purchase of a security, or to effect securities transactions, unless the broker is registered with the Commission or is associated with a registered broker or dealer. Scienter is not required for a violation of this provision. *SEC v. Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003). Section 15(a)'s registration requirement is "of the utmost importance in effecting the purposes of the Act" because it enables the SEC "to exercise discipline over those who may engage in the securities business and it establishes necessary standards with respect to training, experience, and records." *Celsion Corp. v. Stearns Mgmt. Corp.*, 157 F. Supp. 2d 942, 947 (N.D. Ill. 2001), *citing Regional Props v. Financial & Real Estate Consulting, Co.*, 678 F. 2d 552, 562 (5th Cir. 1982).

Section 3(a)(4) of the Exchange Act defines a broker as "any person engaged in the business of effecting transactions in securities for the account of others." In determining whether a person has acted as a broker, several factors are considered. These factors include whether the

[23] 15 U.S.C. §78o(a)(1).

person: 1) actively solicited investors; 2) advised investors as to the merits of an investment; 3) acted with a 'certain regularity of participation in securities transactions'; and 4) received commissions or transaction-based remunerations." *Massachusetts Fin. Serv., Inc. v. Sec. Investor Prot. Corp.*, 411 F. Supp. 411, 415 (D. Mass.), *aff'd*, 545 F.2d 754 (1st Cir. 1976); *see also SEC v. Kramer*, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. 2011); *SEC v. U.S. Pension Trust Corp.*, 2010 U.S. Dist. LEXIS 102938 (S.D. Fla. 2010), *citing, SEC v. Corporate Relations Group, Inc.*, 2003 U.S. Dist. LEXIS 24925, 2003 WL 25570113 at *17 (M.D. Fla. 2003). Funds misappropriated by the perpetrator of a fraudulent scheme can constitute transaction-based compensation equivalent to commissions. *SEC v. George,* 426 F. 3d 786, 793 (6th Cir. 2005) (unregistered defendant violated 15(a) by soliciting 'numerous investors to purchase securities' in a fraudulent offering, holding himself out as an intermediary, and receiving 'transaction-related compensation in the form of investors' money,' which he misappropriated.)

Hernandez was a broker because he regularly participated in securities transactions, received transaction-based compensation or commissions, and was involved in advice to investors, his customers, and actively recruited investors. *SEC v. U.S. Pension Trust Corp.* 2010 U.S. Dist. LEXIS 102938 at *53-54. His entities are also liable as brokers due to Hernandez's conduct and his use of the entities to effect the securities transactions at issue. They acted with regularity of participation in securities transactions. Hernandez and the entities took the customers' funds and placed them in their own bank accounts and spent the money on personal expenses. As such, they received "commissions or transaction-based remunerations. *SEC v. George*, 426 F. 3d at 793.

Hernandez's affiliation with Allstate and AXA does not exempt him from registering as a broker-dealer because he was conducting a private securities business beyond the scope of his

employment at either firm. *See, Roth v. SEC*, 22 F. 3d 1108 (D.C. Cir. 1994), *cert. denied,* 513 U.S. 1015 (1994) (registered representative of a broker-dealer who was conducting a private securities business acted as a "broker" within the meaning of Section 3(a)(4) and in violation of 15(a)); *In re Maria T. Giesige,* 2009 WL 1507584 at *6 (May 29, 2009) (registered representative who, over several months, received $21,000 in commissions for selling unregistered stock to approximately fifty people...violated Section 15(a)).

V. RELIEF REQUESTED

A. Cease and desist order and collateral bars.

The Division request findings of liability for the violations alleged. The ALJ may impose a cease-and-desist order on a person who has violated or caused violations of the federal securities laws. *In the Matter of Terence Michael Coxon,* AP File No. 3-9218, 2003 WL 21991359 at *12 (Aug. 21, 2003). The Division seeks a cease-and-desist order against Hernandez pursuant to Section 8A of the Securities Act,[24] Section 15(b)(6),[25] and Section 21C[26] of the Exchange Act, and Section 9(b) of the Investment Company Act.[27] The Division seeks a cease-and-desist order against Wealth Management, Wealth Financial and DFHR, pursuant to Section 8A of the Securities Act and Sections 15(b)(6) and Section 21C of the Exchange Act. Finally, the Division seeks a cease-and-desist order against HD Mile High pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act.

Based on the violations described herein, Respondents should be ordered to cease and desist from committing or causing violations and future violations as follows: 1) Hernandez, Wealth Management and Wealth Financial from violating Section 17(a) of the Securities Act,

[24] 15 U.S.C. §77h-1.
[25] 78 U.S.C, §78o(b)(6).
[26] 78 U.S.C. §78u-3.
[27] 15 U.S.C. §80a-9(b).

Section 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, 2) DFHR from violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c), and Section 15(a) of the Exchange Act, and 3) HD Mile High from violating Sections 17(a)(1) and (3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) thereunder.

The Division seeks an unqualified collateral bar against Hernandez for his willful violations pursuant to Section 15(b) of the Exchange Act and Section 9(b) of the Investment Company Act. The Division also seeks unqualified collateral bars against Wealth Management, Wealth Financial and DFHR, for their willful violations pursuant to Section 15(b) of the Exchange Act.

B. Disgorgement and prejudgment interest.

Disgorgement is an equitable remedy designed to deprive a wrongdoer of unjust enrichment and to deter others from violating securities laws. *SEC v. First City Fin. Corp.,* 890 F. 2d 1215, 1230 (D.C. Cir. 1989). *United States v. Alcan Aluminum Corp.,* 964, F. 3d 252, 2268-60 (3d Cir. 1992); *SEC v. Hughes Capital Corporation,* 124 F. 3d at 455. The Division seeks disgorgement of ill-gotten gains, plus prejudgment interest, jointly and severally from Hernandez, Wealth Management, Wealth Financial, DFHR, and HD Mile High, pursuant to Section 8A(e) of the Securities Act, Section 21C of the Exchange Act, and against Hernandez pursuant to Section 9(e) of the Investment Company Act.[28]

Joint and several liability should be assessed when defendants collaborated in violating the securities laws, had a close relationship in engaging in the illegal conduct, and the investors' funds are comingled amongst the defendants. *SEC v. First Jersey Securities, Inc.,* 101 F. 3d 1450, 1475 (2d Cir. 1996), *cert. denied,* 522 U.S. 812 (1997); *SEC v. Bass,* 2012 WL 5334743 at

[28] 15 U.S.C. §80a-9(e).

*4 (N.D.N.Y Oct. 26, 2012). Here, disgorgement should be assessed jointly and severally. Joint and several penalties should be assessed because Respondents collaborated in violating the securities laws, had a close relationship in engaging in the illegal conduct, and the customers' funds were comingled in the various bank accounts.

The Division is entitled to prejudgment interest on the disgorgement "based on the rate of interest used by the Internal Revenue Service for the underpayment of federal income tax as set forth in 16 U.S.C. §6621(a)(2); *SEC v. United American Ventures, LLC,* 2012 U.S. Dist. LEXIS 51978 at *15 (D.N.M. 2012).

C. Civil penalties

Based on the willful violations and conduct set forth above, Respondents should be ordered to pay third tier civil penalties pursuant to Section 8A of the Securities Act, Section 21B[29] of the Exchange Act, Section 9(d) of the Investment Company Act.[30] The Division will address the statutory third tier civil penalty amount for Hernandez and each entity in post-hearing briefing.

VI. CONCLUSION

For the reasons discussed in this brief, the Division will seek the relief requested herein and will address the amount of disgorgement and civil penalties in post-hearing briefing.

[29] 15 U.S.C. §78u-2.
[30] 15 U.S.C. §80a-9(d)

Respectfully submitted this 10th day of February, 2014.

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